

Andean Trade Preference Act Pre-Assessment Survey

Internal Control Technical Guide

NOTE: The Andean Trade Preference Act (ATPA) expired December 4, 2001. The Trade Act of 2002 was signed into law by President Bush on August 6, 2002. Title XXXI of the Act provides for the renewal of the ATPA through December 31, 2006.

Objective

Provide guidance in performing a Pre-Assessment Survey (PAS) of the company's internal control for articles entered for preferential treatment as products of ATPA and evaluating the results.

Background

Generally Accepted Government Auditing Standards require the PAS team to obtain a sufficient understanding of internal control to plan the audit and determine the nature, timing, and extent of tests to be performed.

The guidelines and terms in this technical guide are based on *Assessing Internal Controls in Performance Audits*, GAO/OP-4.1.4, published by the United States General Accounting Office, Office of Policy, September 1990; and the American Institute of Certified Public Accountant's *Statement on Auditing Standards No. 78*.

Title II of Public Law 102-182 entitled the ATPA. Codified at 19 U.S.C. 3201 through 3206, ATPA is a special trade program that authorized the president to proclaim duty-free treatment for eligible articles of designated beneficiary countries (BCs).

General Note (GN) 11 of the Harmonized Tariff Schedule of the United States (HTSUS) designates the BCs eligible to claim preference under ATPA. The eligibility requirements of ATPA are provided in 19 CFR 10.201 through 10.208. Exceptions by merchandise description to ATPA are provided in GN 11(d) and in 19 CFR 10.202(b).

To qualify for the ATPA, imported articles must meet the following requirements:

- The imported articles must come to the U.S. directly from the ATPA eligible country; the direct shipment requirements are in 19 CFR 10.204.
- The imported articles must meet the country of origin criteria as stated in 19 CFR 10.205 and be wholly the growth, product or manufacture of the BCs; or be transformed into new or different articles of commerce that have been grown, produced or manufactured in a beneficiary country.
- The imported articles must meet the value content requirements of 19 CFR 10.206. ATPA merchandise that is not wholly the growth, product or manufacture of a BC may be accorded duty-free treatment only if the sum of the direct costs of the processing performed in the BC, plus the cost or value of the materials produced in the BC, is not less than 35 percent of the appraised value.

Merchandise subject to the ATPA appears as "Free or at a reduced duty" in the HTSUS "Special" Rate of Duty sub-column followed by the symbol "J" or "J*" in parenthesis. For articles designated with a J* in the duty free column, the exceptions of General Note 11(d) will apply.

The ATPA is claimed on the imported articles by using the letter J in the Special Program Indicator field of the Automated Commercial System (ACS) database.

Additional guidance may be found in:

- C.S.D. 85-25 (double substantial transformation);
- Ruling 556193, dated 12/23/91 (dual-sourcing);
- Ruling 557087, dated 7/22/93, T.D. 81-282, T.D. 78-399, and C.S.D. 80-208 (unallowable general and administrative costs); and
- Ruling 559010, dated 3/14/96 and T.D. 91-7 (treatment of components in sets).

The Trade Act of 2002 ("the Act") was signed into law by President Bush on August 6, 2002. Title XXXI of the Act provides for the renewal of the ATPA through December 31, 2006. This title may be cited as the Andean Trade Promotion and Drug Eradication Act (ATPDEA). Customs Automated Commercial System (ACS) has been reprogrammed to accept duty-free entry summaries using the special program indicators (SPI) "J" and "J*".

The Act eliminated 19 USC 3203(c), which provided duty reductions for certain goods. Effective immediately by the signing of the Act on August 6, 2002, ATPA reduced rates of duty no longer apply on certain handbags, luggage, flat goods, work gloves, and leather wearing apparel.

Certain articles that were previously excluded from ATPA preferential treatment may become eligible for preferential treatment under the Andean Trade Promotion and Drug Eradication Act once the President determines that a country is eligible for such treatment. Auditors must obtain current information on ATPDEA provisions for imports after August 6, 2002.

Examples of Red Flags

The following examples are conditions that may indicate a potential problem in ATPA.

- The company has insufficiently documented, poorly defined, or no internal control for accurately declaring merchandise entered as ATPA products for Customs purposes.
Examples:
 - ✓ The company does not monitor or interact with the broker on ATPA issues.
 - ✓ The company relies on one employee to handle ATPA issues, and there are poor or no management checks or balances over this employee.
- Responsible person lacks cost accounting knowledge.
- The company import staff lacks knowledge of ATPA eligibility requirements.
- The company offers unreasonable explanations to Customs.
- The company fails to cooperate with or respond to Customs.
- The company has high turnover of people in key positions.
- Significant variance exists between the importer's data and Customs' data.
- Customs (import specialist, account manager, compliance measurement, prior audit) shows history of problems with ATPA merchandise.
- HTSUS numbers that the company frequently uses regarding ATPA have high compliance measurement error rates.
- Imports from a specific exporter, or under an HTSUS number or country of origin that the company uses, have been identified by Customs because of known or suspected ATPA problems.
- The company has a large number of ATPA exporters or a large number of goods for which ATPA is claimed

- The importer does not request, maintain, or review documents supporting the qualification of ATPA imports (e.g. value content requirements).
- The company has a sharp increase of ATPA imports from a prior period.
- The importer claiming ATPA and the exporter are related parties.
- Customs has no prior audits or reviews of the company's ATPA imports.
- The profile identified specific ATPA issues.
- The company dual sources or obtains an interchangeable article from two different countries, where only one of the countries is an ATPA country.
- The articles do not have required markings to distinguish the origin.
- A declaration that assembled ATPA articles declared as wholly produced or manufactured in a beneficiary country appears to be doubtful.
- Value content qualification is marginal, just meeting the 35 percent requirement, increasing the importance of accurate cost computations.
- Direct materials alone are not adequate to meet the 35 percent value content requirement, making accurate direct processing costs particularly important.
- Imported textile and apparel articles are subject to textile restrictions.
- Amounts on cost sheets for unallowable general expenses and profit appear unusually low, indicating allowable costs may be overstated.

Examples of Best Practices

- Internal controls over merchandise entered as ATPA products:
 - ✓ Are in writing;
 - ✓ Include procedures for monitoring and feedback; and
 - ✓ Are monitored by management.
- One manager is ultimately responsible for control of the Import Department, including merchandise entered as ATPA. That manager has knowledge of Customs matters and the authority to ensure that internal control procedures for imports are established and followed by all company departments.
- Written internal control procedures assign ATPA duties and tasks to a position rather than a person.
- The company has good interdepartmental communication regarding ATPA matters.
- The company conducts and documents periodic reviews of merchandise entered as ATPA products, and uses the results to make corrections past and present to entries, and changes to their import operations as appropriate.
- Purchasing, Engineering, other departments, and suppliers provide sufficient descriptions of merchandise to permit a determination of ATPA eligibility.
- Internal control involves a verification process to determine that the imported merchandise qualifies for ATPA.
- The importer has procedures to obtain any required or necessary documentation to support the claim (e.g. penalty provisions if ATPA information is not provided to Customs on demand).
- The importer maintains an ATPA database or listing of imported merchandise that would readily identify ATPA transactions.
- The importer (or the importer's agent) visits the plant in the ATPA country where the products are produced.
- The importer performs an annual review of changes to ATPA.

Examples of ATPA Documents and Information to Review

- Internal control policies and procedures for ensuring ATPA eligibility.
- The company's response to the questionnaire.
- Interviews with company staff concerning actual procedures and controls specific to ATPA imports.
- A company's documentation that supports monitoring and verification of established and/or written internal control for ATPA, including:
 - ✓ An ATPA declaration signed by the person responsible for certifying that all information on the documentation is accurate and complete.
 - ✓ A list of articles by vendor that are products of ATPA countries.
 - ✓ Invoices, specification sheets, or other documents providing a detailed description and origin of the ATPA merchandise.
 - ✓ Bills of lading or other evidence of direct transport to the United States.
 - ✓ For related parties a bill of materials listing of origin of the products used in production.
 - ✓ Travel documents that show that the company has recently visited the ATPA manufacturer and verified the commodities are manufactured, produced, or wholly grown in the ATPA country.
 - ✓ Records from the ATPA producer supporting the company's verification for articles not wholly the growth or product of a BC (such as, cost allocation worksheets, bills of materials, product specification sheets, engineering drawings, work-in-process documents, material inventory records, purchase history reports, and/or material supplier lists).
 - ✓ Country of origin markings on products and components.
 - ✓ Bills of material listing country of origin for components, whether foreign vendors are related or unrelated.
 - ✓ Manufacturer's affidavits as to country of origin of components.
 - ✓ "Where used" reports ("exploded" bills of material) showing that components underwent "double substantial transformation."
 - ✓ Accounting records supporting product cost sheets, including financial statements, post-closing trial balance, detailed chart of accounts, and general ledger detail.

Suggested Testing

PAS team judgement should be used to determine the type and amount of testing needed to evaluate how effective internal control is and to determine whether there is a sufficient risk to warrant proceeding to Assessment Compliance Testing (ACT).

Using the chart and the guidelines below, determine through limited judgmental testing whether the company's internal control is effective.

To determine the extensiveness of internal control testing, it is necessary to evaluate:

1. The **risk exposure**, and
2. The **internal control** system by determining if the controls are in operation, how the controls were applied, how consistently they were applied, and who applied them.

Risk Exposure

Risk exposure is the probability of significant Customs noncompliance. In each step of determining risk exposure, consideration should be given to:

1. Significance (to Customs) and sensitivity (e.g., issues of interest to Congress or the media, or affecting admissibility).
2. Susceptibility (of making incorrect declarations).
3. The existence of any “red flags.”
4. Management support (of strong internal control).
5. Competent personnel (to adequately administer the controls).

Steps to Determine Risk Exposure:

1. Evaluate problems identified in the profile, compliance measurement rates, questionnaire, and concerns raised by the import specialist and account manager.
2. Perform the macro risk analysis tests.
3. Analyze all results to determine the risk exposure level.
4. Evaluation of risk exposure is not simply a one-time process that occurs at the start of the PAS process. Continually reassess risk exposure as more information is gathered from evaluating internal control and performing other work in the PAS.

Macro Risk Analysis Examples

Example A: Low Risk Exposure

The import specialist did not identify specific concerns with the importer’s ATPA program. There are no inconsistencies in information regarding the ATPA program in the importer’s responses in the questionnaire. The PAS team compared the total ATPA merchandise value to the value reported in ACS and determined the variance to be non-significant. The materials used to produce the articles, claimed under the ATPA provisions, were known to be grown, produced, or manufactured in the ATPA beneficiary country. They were directly shipped from the BC to the U.S. Since there were no PAS team concerns and the importer’s import data mirrored Customs ACS data, the risk exposure was considered low.

Example B: High Risk Exposure

The import specialist identified specific concerns with the importer’s ATPA program. The PAS team compared the total ATPA merchandise value claimed by the importer to the value reported in ACS and determined there was a significant variance. A portion of the articles, reported in ACS as duty-free under the ATPA provisions, (but not part of the importers list of ATPA articles) had undergone only packaging operations. Due to the PAS team concerns and the discrepancy between importer data and Customs data, the risk exposure level was considered high.

System of Internal Control

To evaluate the internal control system:

1. Consider the five components of internal control:
 - Control Environment.
 - Risk Assessment.
 - Control Activities.
 - Information and Communication.
 - Monitoring.
2. Review relevant Customs and company documents to identify and understand relevant internal control over entries of ATPA. (Examples of documents and information to review are listed on prior page).
3. Determine whether the company has established and follows procedures by reviewing:
 - Documentary evidence of the results of periodic internal control reviews/testing and corrective action implemented.
 - Documentary evidence (such as a log) of communication with the broker and company departments on ATPA issues, including company testing of broker operations and verification that the broker followed company instructions.
 - Company-specific ATPA rulings requested. Determine whether they are followed.
 - Documentary evidence of intra-company communications, to ensure that correct information is provided to Customs.
 - Training records and materials relating to ATPA used to educate staff on Customs matters.
4. Review written policies and procedures and interview applicable company personnel to complete the appropriate sections of the "Worksheet for Evaluating Internal Control over ATPA".

Note: The internal control assessment should include steps to:

- Identify and understand internal control.
- Determine what is already known about control effectiveness.
- Assess the adequacy of internal control design.
- Determine whether controls are implemented and effective.
- Determine whether transaction processes are documented.

Extensiveness of Audit Tests (Testing Limit)

The purpose of limited PAS testing is to take a survey in order to determine the necessity for and extent of substantive tests. In some circumstances, the PAS team may decide that it probably will not be able to form an opinion based on limited PAS testing. In that case, it may be necessary to proceed immediately to the ACT process. If the PAS team believes that they can form an opinion based on limited PAS testing, test the appropriate number of controls and associated transactions using the table below. Tests may be appropriate for various areas below the total ATPA level that compliance will be reported on. For example, the company may

import from several foreign companies, but testing may be necessary only for companies or products that have been identified as primary risks.

Determining Extensiveness of Audit Tests

Risk Exposure	+	Preliminary Review Internal Control	=	Extensiveness of Audit Test	Testing Limit
High		Weak Adequate Strong		High Moderate to High Low to Moderate	10-20
Moderate		Weak Adequate Strong		Moderate to High Moderate Low	5-15
Low		Weak Adequate Strong		Low to Moderate Low Very Low	1-10

Source: Adapted from *Assessing Internal Controls in Performance Audits*.
Column titled "Testing Limit" reflects Customs test sizes.

Evaluation of Pre-Assessment Survey Testing Results

The following steps are guidance for determining the effectiveness of company's internal control over ATPA.

1. Complete the "Worksheet for Evaluating Internal Control Over ATPA" to determine whether risk determination is acceptable or unacceptable and document why. Put results of ATPA testing in perspective and evaluate confirmed weakness as a whole. The evaluation should consider the results of the internal control testing, problems identified in the profile, and/or concerns raised by the import specialist or account manager. The team must evaluate the PAS results based on the specific situations.

Customs considers risk unacceptable when testing reveals that internal control is not sufficient or effective in providing reasonable assurance that accurate, timely, and complete declarations are reported to Customs.

2. The following will help the PAS team determine whether conditions warrant proceeding to ACT.

- **Do not proceed to ACT (Revenue) if:**

- ✓ Cost benefit analysis warrants no further effort (do not spend a significant amount of resources to identify a potential loss of revenue considered insignificant).
- ✓ The PAS indicated that the ATPA revenue loss was due to an isolated incident.
- ✓ The company agrees with PAS finding(s) and agrees to quantify the loss of revenue within an acceptable timeframe.

- **Do not proceed to ACT (Compliance) if:**

- ✓ An incorrect ATPA eligibility issue was isolated and the importer can show identical entry lines with the ATPA correctly reported.

- ✓ The ATPA eligibility errors were systemic and the importer agreed to develop and implement a Compliance Improvement Plan within an acceptable timeframe.
- **Proceed to ACT (Revenue) if:**
 - ✓ The company does not have adequate internal control, and PAS indicated a material loss of revenue that cannot be quantified without statistical sampling or further review.
 - ✓ The importer will not quantify loss of revenue.
- **Proceed to ACT (Compliance) if:**
 - ✓ The company refuses to take corrective action on systemic errors and it is necessary to calculate a compliance rate.

Note: If substantive tests necessary to determine a compliance rate, or revenue loss, can be quickly performed without extensive effort, the team should immediately perform the substantive tests without proceeding to ACT.

3. Determine whether referrals should be made for enforcement action.

Examples

The following examples of situations that might be encountered under the PAS are *for clarification only*:

Example A: Situation in which the team would not proceed to ACT (Revenue)

Background

Commodities Inc. (CI) imports a number of manufactured goods from Colombia (none wholly a product of Colombia) entered duty free under the ATPA. The ATPA goods are made from materials obtained from both ATPA and non-ATPA countries. The process starts with the CI purchasing department. All goods indicated by purchasing as potentially duty free under ATPA must undergo an analysis to determine whether the good qualifies for ATPA before shipment. The Import Department reviews the documentation acquired by purchasing and by e-mail advises purchasing that the good qualifies for ATPA preference. Purchasing then, as part of the purchase contract requirements, indicates that the ATPA producer is required to furnish all necessary value content information to U.S. Customs should U.S. Customs request the information. A provision added to all trade preference purchase contracts, requires payment of duty, by the producer, for any failure to supply U.S. Customs with the required content information (and resulting disallowance of preferential treatment).

Company's Policies and Procedures

CI has a written company policy (in the CI Customs Procedures Manual) that requires the Import Department review the statement from the ATPA producer on the origin of the materials and other costs used to produce the ATPA goods. Because of trade secrets, material supplier pricing, and content secrecy, the ATPA producer agreed to provide a letter that indicates the article meets the ATPA percentage of value content criteria but no specific value information. As a condition of export, a Statement of Manufacture from the ATPA producer indicating that the goods were produced in the beneficiary country is part of the import documents. All shipments are made directly from the ATPA country to the U.S. In order to make a determination on a good's eligibility the Import Department concludes that the country of origin and the direct

shipment have been met, but must rely on statements from the ATPA vendor for the value content requirements.

Pre-Assessment Survey

Since internal controls indicated all ATPA goods were the subject of an import department review, to determine whether the controls were working, the team:

- Interviewed employees in the Purchasing, Receiving, Shipping, and Import Departments to determine their understanding of the requirements in the company's Procedures manual.
- Performed a macro-test determining that the entered values for Customs and CI of ATPA products for the year examined mirrored each other in the aggregate and by HTS heading.
- Judgmentally selected 10 items from the purchasing department files and determined if there was evidence of the Import Department approval and verification of the brokers entry preparation. These items represented 50 percent of CI's total ATPA merchandise value and 100 percent of the ATPA vendors.
- Compared the information on the shipping form, supporting Country of Origin statement and manufacturer statements to determine whether the information was accurate and the goods were products of an ATPA beneficiary country.
- Issued a Customs request to the ATPA producers for value content information. Reviewed content specifications of the goods produced depicting the products manufactured into the finish goods.

The PAS indicated that the Import Department failed to review and approve one of the 10 goods reviewed. This one good was a purchasing department modification (change of material specifications) to another already approved good. Since the good had already received Import Department approval, Purchasing failed to initiate the necessary internal control review. A Customs review of the good revealed that because of the change in the material specifications the source of some critical materials had changed (from the U.S.) to a non-ATPA country causing the value content requirements of ATPA to fail.

The company agreed to adopt a compliance improvement plan (CIP). The CIP reinforced all departments following existing procedures for all articles adding the phrase "including modifications to existing Import Department approved goods" to existing controls and stressed better interdepartmental communication. The company also agreed to quantify the loss of revenue (LOR) caused by the Import Department not reviewing and approving the modification. Because of this error, the Import Department then performed a reconciliation of all ATPA articles initiated by purchasing, against all ATPA articles approved by the Import Department. The results indicated that there was no additional merchandise not reviewed by the Import Department. Since the company agreed to quantify the LOR, there were no other errors, and CI adopted steps to address the error found, proceeding to ACT was considered unnecessary.

Example B: Situation in which the team would not proceed to ACT (Compliance)

Same situation as Example A above, except that the one modified item because of specification changes not approved by the Import Department caused the good to be entered for ATPA preference using an incorrect HTS number. The company found that despite the failure of the controls, the good as reclassified using the correct HTSUS number, still qualified for ATPA. The CIP provided training in existing procedures, expanded the existing procedure for sending to the Import Department all new goods including "modifications" to existing goods for approval (and

proper classification), and improved interdepartmental communication. Before PAS close, the team was able to confirm there were no additional compliance issues and that controls were in place and working effectively. Therefore, proceeding to ACT was not considered necessary.

Example C: Situation where the team would proceed to ACT (Revenue)

The same controls as Example A above. However, the limited testing of ten goods covered 50 percent of the total ATPA value and 50 percent of the vendors. The PAS review found that the written internal controls were not followed. The IM never determined whether any of the shipments qualified for the ATPA preference. The limited testing showed that 3 of the 10 goods tested (covering 2 vendors) did not meet the ATPA value content requirements, making the three goods dutiable. The two vendors with dutiable merchandise had shipped additional products not tested. Because the company was not compliant with their procedures manual, there was a failure to determine whether any goods qualified for the ATPA trade preference. The company did not agree to quantify the loss of revenue or take corrective action. Since there was a large quantity of untested merchandise and untested vendors the PAS team proceeded to ACT to determine whether there were any additional ineligible ATPA goods, which would result in additional duty.

Example D: Situation in which the team would proceed to ACT (Compliance)

The same controls as Example A above. However, the Import Department did not determine whether the shipments qualified for the ATPA preference. Since the company was not compliant with their Procedures manual, there was a failure to determine whether any of the goods qualified for the ATPA trade preference. Since the PAS team found that the written internal controls were not followed, the decision was made to forego limited testing because ATPA imports represented by merchandise value 60 percent of all imports. The lack of controls for 60 percent of the merchandise value caused the risk exposure to be considered too high for limited testing. Since the company did not agree to or take corrective action, proceeding to ACT using statistical sampling to determine a compliance rate (and possibly a loss of revenue) was considered necessary.

Worksheet for Evaluating Internal Control Over ATPA

Objective: Determine whether the company has procedures designed to effectively control Customs risks related to merchandise entered under provisions of ATPA.

Risk Determination:

Acceptable

Unacceptable

Internal Control	Yes	No	Not Applicable	Internal Control Manual Page Number	Work Paper Reference	Comments
Overall Controls						
Are internal controls over ATPA merchandise formally documented?						
Are written policies and procedures approved by management?						
Are written policies and procedures reviewed and updated periodically?						
Is one manager responsible for control of the Import Department, including ATPA imports?						
Does that manager have knowledge of Customs matters and the authority to ensure that internal control procedures for imports are established and followed by all company departments?						
Does the responsible person have cost accounting knowledge?						

Internal Control	Yes	No	Not Applicable	Internal Control Manual Page Number	Work Paper Reference	Comments
Do written internal control procedures assign ATPA duties and tasks to a position rather than a person?						
Does the company have adequate interdepartmental communication about ATPA matters?						
Does the company conduct and document periodic reviews of ATPA?						
Does the company use the ATPA periodic review results to make corrections to its import operations?						
Does the company use the ATPA periodic reviews to make changes to its import declarations as appropriate?						
Do internal controls involve a verification process to determine that the imported merchandise qualifies for ATPA?						
Is adequate descriptive information provided (by Purchasing, Engineering, other departments, and suppliers) to the Customs Department and/or broker to ensure proper ATPA eligibility?						
Does the importer have procedures to obtain any required or necessary documentation to support the claim (e.g. a contract penalty provision if ATPA information is not provided to Customs on demand)?						

Internal Control	Yes	No	Not Applicable	Internal Control Manual Page Number	Work Paper Reference	Comments
Does the importer maintain an ATPA database or listing of imported merchandise that would readily identify ATPA transactions?						
Does the importer (or the importer's agent) visit the plant in the ATPA country(s) where the products are produced?						
Does the company perform an annual review of changes to ATPA?						
New ATPA Merchandise						
Does management review the classification and eligibility of new ATPA items?						
Is responsibility for the ATPA eligibility process assigned to one knowledgeable individual or department with management oversight?						
Is adequate descriptive information provided to the Customs Department and/or broker by suppliers, engineers, purchasing department, etc. to ensure proper classification?						
Is Customs assistance sought in classifying merchandise (e.g., requesting binding rulings)?						
Entry Review						
Does the company review entries to verify that correct classifications were used?						

Internal Control	Yes	No	Not Applicable	Internal Control Manual Page Number	Work Paper Reference	Comments
Does the company monitor the entry review process to verify that controls were followed?						
Are suppliers required to print company provided HTSUS numbers on invoices and/or packing lists?						
Does the individual reviewing merchandise have adequate knowledge and training on ATPA issues?						
Broker Oversight						
Are HTS classifications for ATPA maintained in a database that is provided to brokers?						
Are brokers required to have written company approval to make classification changes?						
Does the company provide adequate broker oversight?						
Internal Control Conclusions						
Did PAS testing verify that control procedures were being followed?						
Did interviews with responsible persons support control procedures?						

Internal Control	Yes	No	Not Applicable	Internal Control Manual Page Number	Work Paper Reference	Comments
Does the company have internal control procedures to address specific issues identified in the profile?						
List company-specific procedures and controls below (if applicable)						